

COMMONWEALTH OF KENTUCKY
BEFORE THE PUBLIC SERVICE COMMISSION

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In the Matter of:

THE APPLICATION OF THE TODD)	
COUNTY WATER DISTRICT OF TODD)	
AND LOGAN COUNTIES, KENTUCKY,)	Case No. 8943
FOR APPROVAL OF AN INCREASE IN)	
RATES TO BE CHARGED FOR WATER)	
SERVICE)	

O R D E R

On December 5, 1983, the Todd County Water District ("Todd County") filed with the Commission an application requesting authority to increase its water rates. Todd County stated that the requested increase was necessary in order to generate sufficient revenues to defray the costs of operation and maintenance, bond and interest payments, depreciation, and reserve account contributions.

After a review of Todd County's responses to the Commission's Order dated January 11, 1984, the Commission found that the test-year income statement submitted within the application did not reflect actual test-year operations as required by 807 KAR 5:001, Section 9(2). In addition, several discrepancies and procedural errors were found within the responses. Therefore, a conference to address these matters was held at the Commission's offices on February 28, 1984. Each issue was discussed and all problems were substantially resolved.

During the ensuing weeks Todd County filed revised exhibits indicating that it was requesting authority to increase its operating revenue by \$83,105, or 35 percent annually, over its reported adjusted test-year operating revenues of \$238,167.¹ The proposed rates would result in a 72 percent increase in the average residential monthly bill based on usage of 3,000 gallons.²

Based upon the determination herein, Todd County's operating revenue will increase by \$75,962 over actual adjusted test-year operating revenue of \$234,816, an increase of 32 percent. Based upon the rates prescribed in Appendix A, this increase will raise the average customer's bill by \$5.95 or 52 percent.

The Commission scheduled a hearing for May 3, 1984, and on April 6, 1984, directed Todd County to provide notice to its customers of the revised proposed increase and the scheduled hearing. The hearing was conducted as scheduled at the Commission's offices in Frankfort, Kentucky. There were no intervenors in this proceeding.

COMMENTARY

Todd County is a non-profit water utility engaged in the treatment, distribution, and sale of water to approximately 791 customers in Todd, Christian, and Logan counties, Kentucky. Todd County purchases a small quantity (3.5 percent) of its water from South Logan Water District ("South Logan"). The City of Elkton

¹ March, 1984, Todd County Rate Study, Exhibit 8.

² Ibid., Exhibit 6.

("Elkton") purchases, for resale, over 60 percent of the water sold by Todd County.

TEST PERIOD

Todd County proposed and the Commission has accepted the 12-month period ending August 31, 1983, as the test period for determining the reasonableness of the proposed rates. In utilizing the historic test period, the Commission has given full consideration to appropriate known and measurable changes.

REVENUES AND EXPENSES

For the test period Todd County reported a net operating loss of \$78,208. Todd County proposed several pro forma adjustments to revenues and expenses to reflect more current and anticipated operating conditions. The Commission is of the opinion that the proposed adjustments are generally proper and acceptable for rate-making purposes with the following modifications:

Revenue Normalization

Todd County's income statement for the test year ended August 31, 1983, reflected total Operating Revenues of \$238,167 and total Other Income of \$12,094, resulting in total revenues of \$250,261. However, evidence submitted in the record, some of it contradictory, indicates that Todd County did not record all revenues in accordance with the Uniform System of Accounts as prescribed for Class C Water Utilities. As a result, there were numerous misclassifications of revenues on the test-year income statement. The Commission has made appropriate adjustments to correct these misclassifications.

Todd County's statement that revenues received from late penalties and disconnection/reconnection fees are "credited along with revenue from water sold on the income statement"³ suggests that revenues from these sources were commingled with revenues credited to Account No. 461--Metered Sales to General Customers. The Uniform System of Accounts prescribed for Class C Water Utilities requires that additional charges imposed because of failure of customers to pay their water bills on or before a specified date be credited to Account No. 470--Forfeited Discounts, and that fees for changing or reconnecting service be credited to Account No. 471--Miscellaneous Service Revenues. Todd County has stated that \$250 in late payment penalties and \$1,095 in disconnection/reconnection fees were collected during the test year.⁴ The Commission has made appropriate adjustments to reduce Account No. 461 by these amounts to correct these misclassifications.

Todd County has proposed an adjustment to exclude \$777 in utility taxes and \$114 in sales taxes from test-year operating revenues.⁵ A corresponding adjustment to taxes is proposed within operating expenses. However, Todd County has not provided an explanation of the basis for these adjustments. For clarification purposes the Commission addresses this matter forthwith. The

³ Response, Item No. 12 of the Commission's Order dated February 22, 1984.

⁴ Response, Item No. 14 of the Commission's Order dated January 11, 1984.

⁵ March, 1984, Todd County Rate Study, Exhibit 8.

Uniform System of Accounts for Class C Water Utilities requires that taxes collected, pending transmittal to the proper taxing authority, be credited to Account No. 238--Other Current and Accrued Liabilities. Todd County's method of crediting these amounts to Operating Revenues results in an overstatement of revenues. Transmittal of the taxes should be accounted for with a debit to Account No. 238. Todd County, by charging these amounts to taxes, overstates operating expenses. Therefore, the Commission concurs with Todd County's adjustment to reduce operating revenues and operating expenses by \$891.

Todd County has included on its test-year income statement an item of other income identified as "Reimbursements" in the amount of \$754. It is the Commission's determination that the transactions resulting in this balance were not items of other income and therefore has reduced other income by \$754. The basis for this determination is discussed in a subsequent section of this Order.⁶

The Uniform System of Accounts for Class C Water Utilities requires that tap fees be credited to Account No. 271--Contributions in Aid of Construction. Todd County indicates that tap fees have been included in the test year operating revenue account;⁷ however, though repeatedly requested by the Commission, Todd County has not provided a supported figure for the amount

⁶ See Section titled Refunds/Reimbursements.

⁷ Response, Item No. 3 of the Commission's Order dated February 22, 1984.

included. Todd County has stated that the amount of tap fees included in revenue was \$4,700.⁸ Todd County has further suggested that any difference between test year revenues reported on the income statement and revenues generated by the billing analysis is due to the inclusion of tap fees in the revenue account.⁹ The unaccounted-for difference between revenues based on the billing analysis and actual revenues reported on the books is \$2,460. Therefore, this amount is the maximum amount of tap fees that could have been misclassified as test-year operating revenues. The Commission has therefore excluded this amount from operating revenues for rate-making purposes. Todd County should seek to identify the exact amount of tap fees collected during the test period and adjust its books to reflect these amounts in Account No. 271 as required by the Uniform System of Accounts.

Refunds/Reimbursements

Included within Todd County's test-year income statement is an item of other income in the amount of \$754 identified as "Reimbursements." Without comment or explanation, Todd County has excluded this amount from Revenues on its adjusted test-year income statement.¹⁰ After a review of Todd County's "Analysis of

⁸ Response, Item No. 1 of information requested at May 3 Hearing.

⁹ Ibid.

¹⁰ March, 1984, Todd County Rate Study, Exhibit 8.

Other Reimbursements" exhibit,¹¹ the Commission is of the opinion that this amount was for refunds of overpayments to vendors and, therefore, should not have been included as other income on the test-year income statement. To reflect this finding, an adjustment to reduce other income by \$754 has been made.

In considering the nature of these refunds and the accounting method utilized by including them in other income, it is the Commission's conclusion that a corresponding amount was improperly included in various operation and maintenance expense accounts during the test year. This position is supported by Todd County's statement that "refunds are funds collected when overpayments are made to any other company by mistake,"¹² and the "Analysis of Other Reimbursements" exhibit which shows refunds for tubing, insurance, telephone, etc. The implication of these refunds being recorded as revenue is that payments mistakenly made were initially charged to expense and, after the cash refund, the refunded amount was credited to other income rather than removed from the previously charged expense account. Though this method was improper since income and expenses were overstated by an equal amount, there was no distortion of net income. However, to correlate with the previous adjustment to other income and to

¹¹ Response, Item No. 1 of the Commission's Order dated February 22, 1984.

¹² Response, Item No. 18 of the Commission's Order dated January 11, 1984.

correct the overstatement of expenses, an adjustment for rate-making purposes has been made to reduce operation and maintenance expenses by \$754.

Operations Supplies and Expenses/Repairs and Maintenance

Todd County reported Operations Supplies and Expenses in the amount of \$14,610 on its test-year income statement. At the Commission's request, Todd County provided a breakdown as documentation in support of this amount.¹³ An examination of this breakdown indicated that there was a possibility that some items that were expensed by Todd County during the test year should have been capitalized to Utility Plant in Service. Therefore, the Commission requested copies of the invoices associated with these expense items.¹⁴ A review of these invoices indicated that \$6,754 of capital items was improperly charged to Operations Supplies and Expenses during the test year. Therefore, an adjustment has been made to reduce Operations Supplies and Expenses by \$6,754.

At the Commission's request, Todd County filed invoices documenting certain expenditures charged to Transmission and Distribution Expenses, Account No. 652--Maintenance of Services. A review of these invoices indicated that \$405 invoiced for a new main line on January 3, 1983, and paid for by Check No. 1000 should have been capitalized. Therefore, Repairs and Maintenance has been reduced by \$405 to reflect this finding. The Commission

¹³ Response, Item No. 9 of the Commission's Order dated January 11, 1984.

¹⁴ Response, Item No. 9 of the Commission's Order dated February 22, 1984.

requested Todd County to provide any evidence if deemed appropriate as to why the aforementioned expenditures should not be capitalized; however no such evidence was submitted.¹⁵

In applying appropriate depreciation rates, it was determined that a \$234 adjustment to depreciation expense was necessary to reflect the capitalization of these expenditures. Following is a schedule reflecting the accounts, the amounts of the capitalization entries, and the determination of the adjustment to depreciation expenses:

<u>Account No.</u>	<u>Account Title</u>	<u>Amount</u>	<u>Depreciation Rate</u>	<u>Annual Depreciation</u>
343	Trans. & Dist. Mains	\$1,269	40 years	\$ 32
346	Meters	726	10 years	73
347	Meter Installations	5,164	40 years	<u>129</u>
Depreciation Expense Adjustment				<u><u>\$234</u></u>

Bad Debts Expense

In its analysis of the normal annual level of Uncollectible Accounts Expense, Todd County stated that the large amount of Bad Debts expense incurred during the test year was due to a one-time clean-out of Uncollectible Accounts and that the normal annual level for this expense is approximately \$1,000.¹⁶ However, in Exhibit 8 of the Todd County Rate Study, footnote no. 9, an

¹⁵ Response, Item No. 3 of information requested at the May 3, 1984, Hearing.

¹⁶ Response, Item No. 2 of information requested at February 28, 1984, conference; see Commission's letter dated March 5, 1984.

adjustment to increase Uncollectible Accounts expense by \$2,000 from the test year level of \$1,787 to \$3,787 is presented. No explanation or support that this is a known and measurable adjustment has been provided by Todd County. Mr. Carlos Miller of Mayes, Sudderth, and Etheredge, Inc., the engineer who prepared the rate study, stated that this projection is based on an average of the 1981 and 1982 levels of Uncollectible Accounts Expense.¹⁷

Mr. Miller's calculation includes 1982, a year in which there was an extraordinary write-off of Uncollectible Accounts which would render the 2-year average abnormal. Furthermore, while it is normal Commission policy to disregard events subsequent to the test year, to further resolve the contradiction the Commission has examined Todd County's 1983 financial records¹⁸ and has determined that the 1983 level of Uncollectible Accounts expense was \$1,048. Therefore, the Commission finds that \$1,000 should be used herein as the normal annual level of Uncollectible Accounts expense for Todd County for rate-making purposes. An adjustment has been made to reduce the test year expense of \$1,787 by \$787.

Rate Case Amortization

Within Exhibit 8, footnote no. 9, of the Rate Study, Todd County proposed an adjustment to amortize \$8,058 in professional expenses incurred as a result of this rate proceeding over a 3-year period. In determining the annual amortization expense,

¹⁷ Transcript of Evidence, May 3, 1984, p. 18.

¹⁸ 1983 Annual Report, p. 11, line 34.

Todd County used a 36-month annuity at 12 percent annual interest, resulting in a \$266 monthly payment, or \$3,196 annually.

In examining the invoices¹⁹ from the Accountants, Engineers, and Attorneys submitted by Todd County, the Commission finds no provisions for the payment of these fees in monthly installments over a 3-year period at 12 percent annual interest. Furthermore, a \$5,000 invoice submitted by the engineering firm of Mayes, Sudderth, and Etheredge stipulates that the amount billed is due within 10 days after receipt of the notice.²⁰ Moreover, Todd County possesses sufficient cash reserves for immediate payment of these debts and it would be imprudent to carry them as liabilities at an interest rate of 12 percent per annum. Therefore, the Commission finds that the \$8,058 in rate case expenses should be amortized over a 3-year period which results in an adjustment of \$2,686.

Operations Labor

Todd County has indicated that the plant operator, Ricky Harrison, received a relatively substantial wage increase during the test year. Though Todd County did not propose an adjustment to reflect this, it is the Commission's finding that due to the higher wage being paid to Mr. Harrison, Operations Labor expense will increase and an adjustment should be made to reflect the increased cost.

¹⁹ Response, Item No. 6, Commission's Order dated February 22, 1984.

²⁰ Ibid.

In calculating the adjustment, the Commission has applied Mr. Harrison's current wage of \$4.25 per hour²¹ to his test-year labor hours²² of 2,000 regular and 101.5 overtime. This results in a normalized annual wage of \$9,209. In comparing this to Mr. Harrison's test year wage of \$7,750, the Commission finds that Operations Labor should be increased by \$1,549.

After consideration of the aforementioned adjustments, the Commission finds Todd County's adjusted test-period operations to be as follows:

	<u>Actual Test Period</u>	<u>Pro Forma Adjustments</u>	<u>Adjusted Test Period</u>
Operating Revenues	\$ 238,167	\$ <3,351>	\$ 234,816
Operating Expenses	<u>229,669</u>	<u><55,871></u>	<u>173,798</u>
Net Operating Income	8,498	52,520	61,018
Interest Income	11,340	<5,040>	6,300
Other Income	754	<754>	0
Interest Expense	<u>98,800</u>	<u><2,400></u>	<u>96,400</u>
Net Income	<u>\$ <78,208></u>	<u>\$ 49,126</u>	<u>\$ <29,082></u>

REVENUE REQUIREMENTS

Todd County's annual debt service requirement based on a 5-year average is \$119,400. Using the results from the adjusted test year, Todd County's debt service coverage would be .56X. The Commission is of the opinion that this coverage is inadequate and could adversely affect Todd County's financial condition. Therefore, additional revenue of \$75,962 is required to increase the

²¹ Response to Item No. 2, Commission's Order dated February 22, 1984.

²² Response to Item No. 4 of information requested at the May 3, 1984, Hearing.

debt service coverage to a reasonable level of 1.2X.²³ This additional revenue will provide \$310,778 in total operating revenues and after consideration of interest income of \$6,300 will provide net income of \$46,880 which will be sufficient to allow Todd County to pay its operating expenses, meet its debt service requirements and maintain an adequate surplus.

RATE DESIGN

Todd County serves one wholesale customer, Elkton, through a water purchase contract. The contract provides that Todd County shall adjust the rate to Elkton at the end of each year based on the cost of providing service to Elkton. Todd County originally proposed a wholesale rate of \$1.01 per thousand gallons to be charged to Elkton based on a cost of service study performed by Mr. Miller. Subsequently, Todd County filed an amended rate study wherein it proposed to decrease the present wholesale rate of 81 cents per thousand gallons to 73 cents per thousand gallons. The rate of 73 cents per thousand gallons was supplied to the engineer by Todd County and the Commission received no cost justification data to support this decrease in its proposed wholesale rate. At the Commission's request, Todd County filed a third cost of service study which set out a proposed wholesale rate of 86.9 cents

23	Average Debt Service + 20% Coverage	\$143,280
	Adjusted Operating Expenses	<u>173,798</u>
	Total Revenue Requirements	\$317,078
	Adjusted Operating Revenue and Other Income	<u><241,116></u>
	Revenue Deficiency	<u>\$ 75,962</u>

per thousand gallons. This study did not include any costs for Transmission and Distribution nor did it allocate any cost for Administrative and General expenses to Elkton.

Todd County purchases a small quantity of water from South Logan at a rate of \$1.00 per thousand gallons. Todd County filed a cost study with its application which shows that it costs 80.2 cents per thousand gallons to produce the remainder of its water. After reviewing the proposed wholesale rates furnished by Todd County and other evidence of record, the Commission is of the opinion that the cost of service study filed in the original application more accurately reflects the actual cost of providing service to Elkton.

In reviewing the evidence in this case, the Commission finds that the water purchase contract with Elkton has not been approved by the Commission. Notwithstanding any agreement entered into by Todd County, all rates and charges must be applied for and approved by the Commission in accordance with 807 KAR 5:001, Section 9, prior to placing such rates and charges into effect. Therefore, prior to placing into effect any changes in rates and charges to Elkton different than those approved in this Order, Todd County must first obtain Commission approval.

SUMMARY

The Commission, having considered the evidence of record and being advised, is of the opinion and finds that:

1. Todd County must obtain approval of any change in its rates and charges before placing them into effect.

2. The rates in Appendix A are fair, just and reasonable rates for Todd County and will produce gross annual revenue sufficient to pay its operating expenses, service its debt, and provide a reasonable surplus for equity growth.

3. The rates proposed by Todd County would produce revenue in excess of that found to be reasonable herein and, therefore, should be denied upon application of KRS 278.030.

4. Todd County should make necessary adjustments to its books to reflect the Commission's findings with respect to the misclassifications of Revenues and Expenses and the capitalization of capital expenditures and should adjust its accounting practices to conform to the Uniform System of Accounts.

IT IS THEREFORE ORDERED that the rates in Appendix A be and they hereby are approved for service rendered by Todd County on and after the date of this Order.

IT IS FURTHER ORDERED that Todd County shall apply for approval of any change in its rates or charges before placing them into effect.

IT IS FURTHER ORDERED that the rates proposed by Todd County be and they hereby are denied.

IT IS FURTHER ORDERED that Todd County shall make the necessary adjustments to its records in the areas specified herein in order to be in compliance with Commission regulations.

IT IS FURTHER ORDERED that Todd County shall adjust its accounting practices to conform to the Uniform System of Accounts for Class C Water Utilities.

IT IS FURTHER ORDERED that within 30 days from the date of this Order Todd County shall file with this Commission its revised tariff sheets setting out the rates approved herein.

Done at Frankfort, Kentucky, this 13th day of July, 1984.

PUBLIC SERVICE COMMISSION

Richard D. Herman
Chairman

[Signature]
Vice Chairman

[Signature]
Commissioner

ATTEST:

Acting Secretary _____

APPENDIX A

**APPENDIX TO AN ORDER OF THE PUBLIC SERVICE
COMMISSION IN CASE NO. 8943 DATED 6/13/84**

The following rates are prescribed for the customers in the area served by Todd County Water District. All other rates and charges not specifically mentioned herein shall remain the same as those in effect under authority of the Commission prior to the effective date of this Order.

RATES: Monthly

First	2,000 gallons	\$12.00 Minimum Bill
Next	8,000 gallons	5.45 per 1,000 gallons
Next	10,000 gallons	4.10 per 1,000 gallons
Next	20,000 gallons	3.00 per 1,000 gallons
Over	40,000 gallons	2.50 per 1,000 gallons
City of Elkton		\$ 1.02 per 1,000 gallons